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Letter dated 6 July 2004 from the Permanent Representative of Maldives to the United Nations addressed to the President of the Economic and Social Council

I have the honour to forward herewith a memorandum prepared by the Government of the Republic of Maldives outlining its concerns on the issue of its graduation from the list of least developed countries (see annex).

I would be most grateful if you would kindly arrange to have the text of this letter and the memorandum annexed to it circulated as a document of the substantive session of 2004 of the Economic and Social Council under agenda item 13 (a).

(*Signed*) Mohamed **Latheef**
Permanent Representative

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Annex

Memorandum by the Government of Maldives on its Concerns on the Impact of Graduation from the list of Least Developed Countries

June 2004

1. Introduction

This Memorandum has been prepared to explain the main concerns of the Government of Maldives regarding the graduation of the Maldives from the list of Least Developed Countries without putting in place proper mechanisms for a smooth transition. The Memorandum also aims at underscoring the acute need for a *smooth* transition mechanism in view of the vulnerability of the Maldives, its narrow economic base and its structural impediments to development.

2. Background

Least Developed Countries have been identified as those that face *structural handicaps to development* through poverty, a narrow economic base and a low-level of human resource capacity[1]. Hence, the purpose of identifying LDCs has been to grant them special treatment in development assistance, market access and other concessions, which over time have also included less onerous obligations in various international treaty regimes.

To identify LDCs, the UN's Committee for Development Policy (CDP) uses three benchmarks that look at income, the level of human resources development and economic vulnerability. A country has to meet two of these three criteria in two consecutive triennial reviews in order to qualify for graduation.

The question of graduation of Maldives from the list of LDCs first came to the forefront in 1997 when it met the income and human resources development criteria. The conclusion of the 2000 and 2003 reviews was the same. The Maldives has been challenging the suitability of the criteria and the accuracy of the information used to judge its performance. It has also been expressing concern over adverse consequences of premature graduation. As a result, the Economic and Social Council (ECOSOC) in 2000 decided to defer the consideration of graduation of the Maldives until 2003 in order to address the issues raised by the Government of Maldives[2]. Several modifications have been made to the criteria over time by the CDP making the indicators more sensitive to the actual situation of the countries being examined.

However, the primary concerns of the Maldives over graduation still persist. These are, that (i) the criteria do not sufficiently capture the development constraints and handicaps of the Maldives as a small island state; (ii) the country still remains dependent on development aid, technical assistance and concessional financing; and (iii) its market access would be seriously imperiled by the loss of LDC status.

The ECOSOC in 2000 by its resolution 2000/34 called for two reports in the interest of observing the principle that graduation should not leave a country worse off than before. One report was to be submitted by UNCTAD incorporating an assessment of the impact of graduation of Maldives, and the other by the Secretary-General on the arrangements made by the donors in response to UNGA

[1] 2003 UNCTAD Vulnerability Profile of Maldives.
[2] ECOSOC resolution 2000/34 of 28 July 2000.

resolution 46/206 to ensure *smooth transition* to graduating countries. These two reports have only been partly completed as of to date.

3. Concerns on the impact of graduation

The Government of Maldives has been expressing its concerns on the impact of graduation and the CDP has been acknowledging these concerns in its reports of 2001, 2002 and 2003. The CDP in its 2003 report stated that "the Committee recognizes that Maldives faces special difficulties and costs because it is a small, widely dispersed island economy and that it may loose important international benefits if it graduates from the list of least developed countries"[3]. Its recognition of these structural handicaps and potential exogenous shocks led the Committee to "stress the necessity to put in place a smooth transition strategy" in its report of 2004.

Although there has been no concrete assessment of the costs of graduation for the Maldives, the 2003 UNCTAD country profile on the Maldives do highlight a number of issues such as international trade, development financing and technical assistance that are important to the Maldives. A number of critical issues such as the impact on macroeconomic performance and on demographic transition, though, have not been addressed in the UNCTAD profile. The CDP report too has not addressed these basic issues.

Following are some of the concerns in brief which demonstrate the magnitude of the costs of graduation and the rationale for a *smooth* transition mechanism:

a. Loss of preferential treatment in trade and access to markets

Graduation would undermine the viability of the fisheries sector due to the loss of concessionary access to markets. As the UNCTAD profile notes, graduation would lead to the imposition of a 24.3% tariff on exports of canned and fresh fish products to EU markets as the Maldives will loose eligibility for duty-free access granted by EU to LDCs[4]. Over 95% of the Maldives canned tuna are exported to the EU market. Fisheries sector being the second most important industry in the Maldives (10% of total foreign exchange earnings, 11% of the work force, and 65% of the population depend directly or indirectly), losing preferential access to markets would have serious adverse socio-economic repercussions on the country as the Maldives will not be able to compete in the EU market. In addition, fisheries sector is often the only source of employment in the atolls. Thus, graduation would further increase the high income disparities, and disrupt and dislocate efforts to develop the atolls.

Graduation would also affect the garment industry severely as exports depend on the rules of origin criteria. This is important to a country that lacks natural resources. Thus, loss of preferential access will cause the garment industry to shut down and would decrease the attraction for developing other manufactured goods.

[3] CDP Report 2003, para 21.
[4] UNCTAD 2003.

Moreover, graduation would imply that the Maldives will face more onerous obligations in multilateral regimes such as the WTO. Graduation will also possibly deny the Maldives of the benefits under the WTO Integrated Framework for Trade Related Technical Assistance.

b. Decline in foreign aid (ODA)

Donor agencies have always exhibited preference to LDCs in their offer of aid and even in their offer of concessional lending. As the **UNCTAD profile**[5] notes "there is a paramount need for maximum concessionary financing" for the Maldives to sustain its current development programmes. Thus, graduation from the list of LDCs would disrupt the development process as 60% of total development expenditure is derived from foreign aid (grants and concessional loans) and as 80% of total expenditure on socio-economic services is derived from foreign aid. The country's efforts towards sustainable development would, therefore, be severely undermined.

c. Increase in debt burden

With the loss of concessionary financing from foreign aid, the Maldives will have to rely on non-concessionary financing and on the open capital market which in turn will increase the debt servicing burden. Higher interest rates and shorter repayment periods will significantly increase the cost of capital and lower capital efficiency in the economy. Even if Maldives were able to manage economic growth the increase in debt burden would have a crushing effect on the fragile economy.

d. Loss of technical assistance

UNCTAD profile[6] highlights that there is a permanent need for the Maldives to strengthen institutional capacities. Given the relative scarcity of skilled manpower, graduation would cease the wide range of technical assistance that the Maldives is granted under the least developed country regime. A significant percentage of current aid comes in the form of technical assistance aimed at enhancing human resource development and capacity building.

e. Loss of other support measures

By virtue of its LDC status, the Maldives has been receiving special assistance from the UN and its related bodies, other multinational institutions and bilateral donors. These include provision of funds for participation in international conferences, negotiations, seminars, workshops and training programmes. Graduation would eliminate such support, severely affecting the ability of the country to participate in international fora and causing an extra strain on the budgetary resources.

[5] 2003 UNCTAD Vulnerability Profile of Maldives.
[6] ibid.

4. Importance of a smooth transition mechanism

The UN General Assembly in its resolution 46/206 has stipulated that graduation should not disrupt the development of a country. The ECOSOC in its resolutions 2000/34, 2001/43 and 2002/36 and the CDP in its reports for 2001, 2002 and 2003 has also stressed the need for examining the issues relating to graduation. In addition, the CDP during the Sixth Session held from 29 March to 2 April 2004, stressed the necessity to put in place a smooth transition strategy by the graduating countries themselves and the international community to avoid a negative shock from graduation.

The Government of Maldives has repeatedly emphasized the importance of establishing a smooth transition mechanism as stipulated by the General Assembly and the ECOSOC. Such measures should ensure the provision of adequate technical assistance, grant aid and concessionary finance and the enjoyment of trade related preferences for a prolonged period to avoid any disruptions to growth and sustainable development. The articulation of specific measures, specific commitments and specific timeframes are essential to meet the CDP declaration that graduation is likely to present different countries with different challenges. CDP has, therefore, spelled out a guiding principle that specific transition support measures, monitoring arrangements and the period of transition shall be decided on a case-by-case basis[7].

It is therefore imperative that not only a concrete assessment of the costs of graduation for each country be made, but also that concrete measures are also set in place to initiate a dynamic process of sustainable development. In the absence of these measures, "a sudden withdrawal of external support is likely to constitute such a shock and to have negative effects, possibly reversing some of the development progress achieved"[8]. Hence, it would not be prudent to graduate first and then commence work on commitments for special treatment.

The Government of Maldives, thus, once again reiterates the importance of giving operational effect to the fundamental principles asserted by the General Assembly and ECOSOC resolutions so as to provide for adjustment costs and measures for longer-term sustainable development before graduating any LDC, including the Maldives, from the LDC list.

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[7] 2004 CDP Report, Chapter 1, Recommendation 4(ii).
[8] 2003 CDP Report.